

time, however, B's share of liabilities of the partnership increases by \$150. Only the net increase or decrease in B's share of the liabilities of the partnership and B's individual liabilities is taken into account in applying section 752. Because there is no net change, B is not treated as having contributed money to the partnership or as having received a distribution of money from the partnership under paragraph (b) or (c) of this section. Therefore B's basis for B's partnership interest is \$1,000 (B's basis for the contributed property).

Example 2. Merger or consolidation of partnerships holding property encumbered by liabilities. (i) B owns a 70 percent interest in partnership T. Partnership T's sole asset is property X, which is encumbered by a \$900 liability. Partnership T's adjusted basis in property X is \$600, and the value of property X is \$1,000. B's adjusted basis in its partnership T interest is \$420. B also owns a 20 percent interest in partnership S. Partnership S's sole asset is property Y, which is encumbered by a \$100 liability. Partnership S's adjusted basis in property Y is \$200, the value of property Y is \$1,000, and B's adjusted basis in its partnership S interest is \$40.

(ii) Partnership T and partnership S merge under section 708(b)(2)(A). Under section 708(b)(2)(A) and § 1.708-1(c)(1), partnership T is considered terminated and the resulting partnership is considered a continuation of partnership S. Partnerships T and S undertake the form described in § 1.708-1(c)(3)(i) for the partnership merger. Under § 1.708-1(c)(3)(i), partnership T contributes property X and its \$900 liability to partnership S in exchange for an interest in partnership S. Immediately thereafter, partnership T distributes the interests in partnership S to its partners in liquidation of their interests in partnership T. B owns a 25 percent interest in partnership S after partnership T distributes the interests in partnership S to B.

(iii) Under paragraph (f) of this section, B nets the increases and decreases in its share of partnership liabilities associated with the merger of partnership T and partnership S. Before the merger, B's share of partnership liabilities was \$650 (B had a \$630 share of partnership liabilities in partnership T and a \$20 share of partnership liabilities in partnership S immediately before the merger). B's share of S's partnership liabilities after the merger is \$250 (25 percent of S's total partnership liabilities of \$1,000). Accordingly, B has a \$400 net decrease in its share of S's partnership liabilities. Thus, B is treated as receiving a \$400 distribution from partnership S under section 752(b). Because B's adjusted basis in its partnership S interest before the deemed distribution under section 752(b) is \$460 (\$420 + \$40), B will not recognize gain under section 731. After the merger, B's adjusted basis in its partnership S interest is \$60.

(h) *Sale or exchange of a partnership interest.* If a partnership interest is sold or exchanged, the reduction in the transferor partner's share of partnership liabilities is treated as an amount realized under section 1001 and the regulations thereunder. For example, if a partner sells an interest in a partnership for \$750 cash and transfers to the purchaser the partner's share of partnership liabilities in the amount of \$250, the seller realizes \$1,000 on the transaction.

(i) *Bifurcation of partnership liabilities.* If one or more partners bears the economic risk of loss as to part, but not all, of a partnership liability represented by a single contractual obligation, that liability is treated as two or more separate liabilities for purposes of section 752. The portion of the liability as to which one or more partners bear the economic risk of loss is a recourse liability and the remainder of the liability, if any, is a nonrecourse liability.

[T.D. 8380, 56 FR 66351, Dec. 23, 1991, as amended by T.D. 8925, 66 FR 723, Jan. 4, 2001; T.D. 9207, 70 FR 30343, May 26, 2005]

§ 1.752-2 Partner's share of recourse liabilities.

(a) *In general.* A partner's share of a recourse partnership liability equals the portion of that liability, if any, for which the partner or related person bears the economic risk of loss. The determination of the extent to which a partner bears the economic risk of loss for a partnership liability is made under the rules in paragraphs (b) through (k) of this section.

(b) *Obligation to make a payment—(1) In general.* Except as otherwise provided in this section, a partner bears the economic risk of loss for a partnership liability to the extent that, if the partnership constructively liquidated, the partner or related person would be obligated to make a payment to any person (or a contribution to the partnership) because that liability becomes due and payable and the partner or related person would not be entitled to reimbursement from another partner or person that is a related person to another partner. Upon a constructive liquidation, all of the following events are deemed to occur simultaneously:

(i) All of the partnership's liabilities become payable in full;

(ii) With the exception of property contributed to secure a partnership liability (see § 1.752-2(h)(2)), all of the partnership's assets, including cash, have a value of zero;

(iii) The partnership disposes of all of its property in a fully taxable transaction for no consideration (except relief from liabilities for which the creditors's right to repayment is limited solely to one or more assets of the partnership);

(iv) All items of income, gain, loss, or deduction are allocated among the partners; and

(v) The partnership liquidates.

(2) *Treatment upon deemed disposition.* For purposes of paragraph (b)(1) of this section, gain or loss on the deemed disposition of the partnership's assets is computed in accordance with the following:

(i) If the creditor's right to repayment of a partnership liability is limited solely to one or more assets of the partnership, gain or loss is recognized in an amount equal to the difference between the amount of the liability that is extinguished by the deemed disposition and the tax basis (or book value to the extent section 704(c) or § 1.704-1(b)(4)(i) applies) in those assets.

(ii) A loss is recognized equal to the remaining tax basis (or book value to the extent section 704(c) or § 1.704-1(b)(4)(i) applies) of all the partnership's assets not taken into account in paragraph (b)(2)(i) of this section.

(3) *Obligations recognized.* The determination of the extent to which a partner or related person has an obligation to make a payment under paragraph (b)(1) of this section is based on the facts and circumstances at the time of the determination. All statutory and contractual obligations relating to the partnership liability are taken into account for purposes of applying this section, including:

(i) Contractual obligations outside the partnership agreement such as guarantees, indemnifications, reimbursement agreements, and other obligations running directly to creditors or to other partners, or to the partnership;

(ii) Obligations to the partnership that are imposed by the partnership agreement, including the obligation to make a capital contribution and to restore a deficit capital account upon liquidation of the partnership; and

(iii) Payment obligations (whether in the form of direct remittances to another partner or a contribution to the partnership) imposed by state law, including the governing state partnership statute.

To the extent that the obligation of a partner to make a payment with respect to a partnership liability is not recognized under this paragraph (b)(3), paragraph (b) of this section is applied as if the obligation did not exist.

(4) *Contingent obligations.* A payment obligation is disregarded if, taking into account all the facts and circumstances, the obligation is subject to contingencies that make it unlikely that the obligation will ever be discharged. If a payment obligation would arise at a future time after the occurrence of an event that is not determinable with reasonable certainty, the obligation is ignored until the event occurs.

(5) *Reimbursement rights.* A partner's or related person's obligation to make a payment with respect to a partnership liability is reduced to the extent that the partner or related person is entitled to reimbursement from another partner or a person who is a related person to another partner.

(6) *Deemed satisfaction of obligation.* For purposes of determining the extent to which a partner or related person has a payment obligation and the economic risk of loss, it is assumed that all partners and related persons who have obligations to make payments actually perform those obligations, irrespective of their actual net worth, unless the facts and circumstances indicate a plan to circumvent or avoid the obligation. See paragraphs (j) and (k) of this section.

(c) *Partner or related person as lender—*
(1) *In general.* A partner bears the economic risk of loss for a partnership liability to the extent that the partner or a related person makes (or acquires an interest in) a nonrecourse loan to the partnership and the economic risk

of loss for the liability is not borne by another partner.

(2) *Wrapped debt.* If a partnership liability is owed to a partner or related person and that liability includes (*i.e.*, is “wrapped” around) a nonrecourse obligation encumbering partnership property that is owed to another person, the partnership liability will be treated as two separate liabilities. The portion of the partnership liability corresponding to the wrapped debt is treated as a liability owed to another person.

(d) *De minimis exceptions*—(1) *Partner as lender.* The general rule contained in paragraph (c)(1) of this section does not apply if a partner or related person whose interest (directly or indirectly through one or more partnerships including the interest of any related person) in each item of partnership income, gain, loss, deduction, or credit for every taxable year that the partner is a partner in the partnership is 10 percent or less, makes a loan to the partnership which constitutes qualified nonrecourse financing within the meaning of section 465(b)(6) (determined without regard to the type of activity financed).

(2) *Partner as guarantor.* The general rule contained in paragraph (b)(1) of this section does not apply if a partner or related person whose interest (directly or indirectly through one or more partnerships including the interest of any related person) in each item of partnership income, gain, loss, deduction, or credit for every taxable year that the partner is a partner in the partnership is 10 percent or less, guarantees a loan that would otherwise be a nonrecourse loan of the partnership and which would constitute qualified nonrecourse financing within the meaning of section 465(b)(6) (without regard to the type of activity financed) if the guarantor had made the loan to the partnership.

(e) *Special rule for nonrecourse liability with interest guaranteed by a partner*—(1) *In general.* For purposes of this section, if one or more partners or related persons have guaranteed the payment of more than 25 percent of the total interest that will accrue on a partnership nonrecourse liability over its remaining term, and it is reasonable to expect

that the guarantor will be required to pay substantially all of the guaranteed future interest if the partnership fails to do so, then the liability is treated as two separate partnership liabilities. If this rule applies, the partner or related person that has guaranteed the payment of interest is treated as bearing the economic risk of loss for the partnership liability to the extent of the present value of the guaranteed future interest payments. The remainder of the stated principal amount of the partnership liability constitutes a nonrecourse liability. Generally, in applying this rule, it is reasonable to expect that the guarantor will be required to pay substantially all of the guaranteed future interest if, upon a default in payment by the partnership, the lender can enforce the interest guaranty without foreclosing on the property and thereby extinguishing the underlying debt. The guarantee of interest rule continues to apply even after the point at which the amount of guaranteed interest that will accrue is less than 25 percent of the total interest that will accrue on the liability.

(2) *Computation of present value.* The present value of the guaranteed future interest payments is computed using a discount rate equal to either the interest rate stated in the loan documents, or if interest is imputed under either section 483 or section 1274, the applicable federal rate, compounded semi-annually. The computation takes into account any payment of interest that the partner or related person may be required to make only to the extent that the interest will accrue economically (determined in accordance with section 446 and the regulations thereunder) after the date of the interest guarantee. If the loan document contains a variable rate of interest that is an interest rate based on current values of an objective interest index, the present value is computed on the assumption that the interest determined under the objective interest index on the date of the computation will remain constant over the term of the loan. The term “objective interest index” has the meaning given to it in section 1275 and the regulations thereunder (relating to

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variable rate debt instruments). Examples of an objective interest index include the prime rate of a designated financial institution, LIBOR (London Interbank Offered Rate), and the applicable federal rate under section 1274(d).

(3) *Safe harbor.* The general rule contained in paragraph (e)(1) of this section does not apply to a partnership nonrecourse liability if the guarantee of interest by the partner or related person is for a period not in excess of the lesser of five years or one-third of the term of the liability.

(4) *De minimis exception.* The general rule contained in paragraph (e)(1) of this section does not apply if a partner or related person whose interest (directly or indirectly through one or more partnerships including the interest of any related person) in each item of partnership income, gain, loss, deduction, or credit for every taxable year that the partner is a partner in the partnership is 10 percent or less, guarantees the interest on a loan to that partnership which constitutes qualified nonrecourse financing within the meaning of section 465(b)(6) (determined without regard to the type of activity financed). An allocation of interest to the extent paid by the guarantor is not treated as a partnership item of deduction or loss subject to the 10 percent or less rule.

(f) *Examples.* The following examples illustrate the principles of paragraphs (a) through (e) of this section.

Example 1. Determining when a partner bears the economic risk of loss. A and B form a general partnership with each contributing \$100 in cash. The partnership purchases an office building on leased land for \$1,000 from an unrelated seller, paying \$200 in cash and executing a note to the seller for the balance of \$800. The note is a general obligation of the partnership, *i.e.*, no partner has been relieved from personal liability. The partnership agreement provides that all items are allocated equally except that tax losses are specially allocated 90% to A and 10% to B and that capital accounts will be maintained in accordance with the regulations under section 704(b), including a deficit capital account restoration obligation on liquidation. In a constructive liquidation, the \$800 liability becomes due and payable. All of the partnership's assets, including the building, are deemed to be worthless. The building is deemed sold for a value of zero. Capital ac-

counts are adjusted to reflect the loss on the hypothetical disposition, as follows:

	A	B
Initial contribution	\$100	\$100
Loss on hypothetical sale	(900)	(100)
	(\$800)	\$0

Other than the partners' obligation to fund negative capital accounts on liquidation, there are no other contractual or statutory payment obligations existing between the partners, the partnership and the lender. Therefore, \$800 of the partnership liability is classified as a recourse liability because one or more partners bears the economic risk of loss for non-payment. B has no share of the \$800 liability since the constructive liquidation produces no payment obligation for B. A's share of the partnership liability is \$800 because A would have an obligation in that amount to make a contribution to the partnership.

Example 2. Recourse liability; deficit restoration obligation. C and D each contribute \$500 in cash to the capital of a new general partnership, CD. CD purchases property from an unrelated seller for \$1,000 in cash and a \$9,000 mortgage note. The note is a general obligation of the partnership, *i.e.*, no partner has been relieved from personal liability. The partnership agreement provides that profits and losses are to be divided 40% to C and 60% to D. C and D are required to make up any deficit in their capital accounts. In a constructive liquidation, all partnership assets are deemed to become worthless and all partnership liabilities become due and payable in full. The partnership is deemed to dispose of all its assets in a fully taxable transaction for no consideration. Capital accounts are adjusted to reflect the loss on the hypothetical disposition, as follows:

	C	D
Initial contribution	\$500	\$500
Loss on hypothetical sale	(4,000) (\$3,500)	(6,000) (\$5,500)

C's capital account reflects a deficit that C would have to make up to \$3,500 and D's capital account reflects a deficit that D would have to make up of \$5,500. Therefore, the \$9,000 mortgage note is a recourse liability because one or more partners bear the economic risk of loss for the liability. C's share of the recourse liability is \$3,500 and D's share is \$5,500.

Example 3. Guarantee by limited partner; partner deemed to satisfy obligation. E and F form a limited partnership. E, the general partner, contributes \$2,000 and F, the limited partner, contributes \$8,000 in cash to the

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partnership. The partnership agreement allocates losses 20% to E and 80% to F until F's capital account is reduced to zero, after which all losses are allocated to E. The partnership purchases depreciable property for \$25,000 using its \$10,000 cash and a \$15,000 recourse loan from a bank. F guarantees payment of the \$15,000 loan to the extent the loan remains unpaid after the bank has exhausted its remedies against the partnership. In a constructive liquidation, the \$15,000 liability becomes due and payable. All of the partnership's assets, including the depreciable property, are deemed to be worthless. The depreciable property is deemed sold for a value of zero. Capital accounts are adjusted to reflect the loss on the hypothetical disposition, as follows:

	E	F
Initial contribution	\$2,000	\$8,000
Loss on hypothetical sale	(17,000)	(8,000)
	(\$15,000)	\$0

E, as a general partner, would be obligated by operation of law to make a net contribution to the partnership of \$15,000. Because E is assumed to satisfy that obligation, it is also assumed that F would not have to satisfy F's guarantee. The \$15,000 mortgage is treated as a recourse liability because one or more partners bear the economic risk of loss. E's share of the liability is \$15,000, and F's share is zero. This would be so even if E's net worth at the time of the determination is less than \$15,000, unless the facts and circumstances indicate a plan to circumvent or avoid E's obligation to contribute to the partnership.

Example 4. Partner guarantee with right of subrogation. G, a limited partner in the GH partnership, guarantees a portion of a partnership liability. The liability is a general obligation of the partnership, *i.e.*, no partner has been relieved from personal liability. If under state law G is subrogated to the rights of the lender, G would have the right to recover the amount G paid to the recourse lender from the general partner. Therefore, G does not bear the economic risk of loss for the partnership liability.

Example 5. Bifurcation of partnership liability; guarantee of part of nonrecourse liability. A partnership borrows \$10,000, secured by a mortgage on real property. The mortgage note contains an exoneration clause which provides that in the event of default, the holder's only remedy is to foreclose on the property. The holder may not look to any other partnership asset or to any partner to pay the liability. However, to induce the lender to make the loan, a partner guarantees payment of \$200 of the loan principal. The exoneration clause does not apply to the partner's guarantee. If the partner paid pur-

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suant to the guarantee, the partner would be subrogated to the rights of the lender with respect to \$200 of the mortgage debt, but the partner is not otherwise entitled to reimbursement from the partnership or any partner. For purposes of section 752, \$200 of the \$10,000 mortgage liability is treated as a recourse liability of the partnership and \$9,800 is treated as a nonrecourse liability of the partnership. The partner's share of the recourse liability of the partnership is \$200.

Example 6. Wrapped debt. I, an individual, purchases real estate from an unrelated seller for \$10,000, paying \$1,000 in cash and giving a \$9,000 purchase mortgage note on which I has no personal liability and as to which the seller can look only to the property for satisfaction. At a time when the property is worth \$15,000, I sells the property to a partnership in which I is a general partner. The partnership pays for the property with a partnership purchase money mortgage note of \$15,000 on which neither the partnership nor any partner (or person related to a partner) has personal liability. The \$15,000 mortgage note is a wrapped debt that includes the \$9,000 obligation to the original seller. The liability is a recourse liability to the extent of \$6,000 because I is the creditor with respect to the loan and I bears the economic risk of loss for \$6,000. I's share of the recourse liability is \$6,000. The remaining \$9,000 is treated as a partnership nonrecourse liability that is owed to the unrelated seller.

Example 7. Guarantee of interest by partner treated as part recourse and part nonrecourse. On January 1, 1992, a partnership obtains a \$4,000,000 loan secured by a shopping center owned by the partnership. Neither the partnership nor any partner has any personal liability under the loan documents for repayment of the stated principal amount. Interest accrues at a 15 percent annual rate and is payable on December 31 of each year. The principal is payable in a lump sum on December 31, 2006. A partner guarantees payment of 50 percent of each interest payment required by the loan. The guarantee can be enforced without first foreclosing on the property. When the partnership obtains the loan, the present value (discounted at 15 percent, compounded annually) of the future interest payments is \$3,508,422, and of the future principal payment is \$491,578. If tested on that date, the loan would be treated as a partnership liability of \$1,754,211 (\$3,508,422 \times .5) for which the guaranteeing partner bears the economic risk of loss and a partnership nonrecourse liability of \$2,245,789 (\$1,754,211 + \$491,578).

Example 8. Contingent obligation not recognized. J and K form a general partnership with cash contributions of \$2,500 each. J and K share partnership profits and losses equally. The partnership purchases an apartment building for its \$5,000 of cash and a \$20,000 nonrecourse loan from a commercial bank.

The nonrecourse loan is secured by a mortgage on the building. The loan documents provide that the partnership will be liable for the outstanding balance of the loan on a recourse basis to the extent of any decrease in the value of the apartment building resulting from the partnership's failure properly to maintain the property. There are no facts that establish with reasonable certainty the existence of any liability on the part of the partnership (and its partners) for damages resulting from the partnership's failure properly to maintain the building. Therefore, no partner bears the economic risk of loss, and the liability constitutes a nonrecourse liability. Under § 1.752-3, J and K share this nonrecourse liability equally because they share all profits and losses equally.

(g) *Time-value-of-money considerations*—(1) *In general.* The extent to which a partner or related person bears the economic risk of loss is determined by taking into account any delay in the time when a payment or contribution obligation with respect to a partnership liability is to be satisfied. If a payment obligation with respect to a partnership liability is not required to be satisfied within a reasonable time after the liability becomes due and payable, or if the obligation to make a contribution to the partnership is not required to be satisfied before the later of—

- (i) The end of the year in which the partner's interest is liquidated, or
- (ii) 90 days after the liquidation,

the obligation is recognized only to the extent of the value of the obligation.

(2) *Valuation of an obligation.* The value of a payment or contribution obligation that is not required to be satisfied within the time period specified in paragraph (g)(1) of this section equals the entire principal balance of the obligation only if the obligation bears interest equal to or greater than the applicable federal rate under section 1274(d) at the time of valuation, commencing on—

- (i) In the case of a payment obligation, the date that the partnership liability to a creditor or other person to whom the obligation relates becomes due and payable, or
- (ii) In the case of a contribution obligation, the date of the liquidation of the partner's interest in the partnership. If the obligation does not bear interest at a rate at least equal to the

applicable federal rate at the time of valuation, the value of the obligation is discounted to the present value of all payments due from the partner or related person (*i.e.*, the imputed principal amount computed under section 1274(b)). For purposes of making this present value determination, the partnership is deemed to have constructively liquidated as of the date on which the payment obligation is valued and the payment obligation is assumed to be a debt instrument subject to the rules of section 1274 (*i.e.*, the debt instrument is treated as if it were issued for property at the time of the valuation).

(3) *Satisfaction of obligation with partner's promissory note.* An obligation is not satisfied by the transfer to the obligee of a promissory note by a partner or related person unless the note is readily tradeable on an established securities market.

(4) *Example.* The following example illustrates the principle of paragraph (g) of this section.

Example. Value of obligation not required to be satisfied within specified time period. A, the general partner, and B, the limited partner, each contributes \$10,000 to partnership AB. AB purchases property from an unrelated seller for \$20,000 in cash and a \$70,000 recourse purchase money note. The partnership agreement provides that profits and losses are to be divided equally. A and B are required to make up any deficit in their capital accounts. While A is required to restore any deficit balance in A's capital account within 90 days after the date of liquidation of the partnership, B is not required to restore any deficit for two years following the date of liquidation. The deficit in B's capital account will not bear interest during that two-year period. In a constructive liquidation, all partnership assets are deemed to become worthless and all partnership liabilities become due and payable in full. The partnership is deemed to dispose of all its assets in a fully taxable transaction for no consideration. Capital accounts are adjusted to reflect the loss on the hypothetical disposition, as follows:

	A	B
Initial contribution	\$10,000	\$10,000
Loss on hypothetical sale	(45,000)	(45,000)
	(35,000)	(35,000)

A's and B's capital accounts each reflect deficits of \$35,000. B's obligation to make a

contribution pursuant to B's deficit restoration obligation is recognized only to the extent of the fair market value of that obligation at the time of the constructive liquidation because B is not required to satisfy that obligation by the later of the end of the partnership taxable year in which B's interest is liquidated or within 90 days after the date of the liquidation. Because B's obligation does not bear interest, the fair market value is deemed to equal the imputed principal amount under section 1274(b). Under section 1274(b), the imputed principal amount of a debt instrument equals the present value of all payments due under the debt instrument. Assume the applicable federal rate with respect to B's obligation is 10 percent compounded semiannually. Using this discount rate, the present value of the \$35,000 payment that B would be required to make two years after the constructive liquidation to restore the deficit balance in B's capital account equals \$28,795. To the extent that B's deficit restoration obligation is not recognized, it is assumed that B's obligation does not exist. Therefore, A, as the sole general partner, would be obligated by operation of law to contribute an additional \$6,205 of capital to the partnership. Accordingly, under paragraph (g) of this section, B bears the economic risk of loss for \$28,795 and A bears the economic risk of loss for \$41,205 (\$35,000 + \$6,205).

(h) *Partner providing property as security for partnership liability*—(1) *Direct pledge*. A partner is considered to bear the economic risk of loss for a partnership liability to the extent of the value of any the partner's or related person's separate property (other than a direct or indirect interest in the partnership) that is pledged as security for the partnership liability.

(2) *Indirect pledge*. A partner is considered to bear the economic risk of loss for a partnership liability to the extent of the value of any property that the partner contributes to the partnership solely for the purpose of securing a partnership liability. Contributed property is not treated as contributed solely for the purpose of securing a partnership liability unless substantially all of the items of income, gain, loss, and deduction attributable to the contributed property are allocated to the contributing partner, and this allocation is generally greater than the partner's share of other significant items of partnership income, gain, loss, or deduction.

(3) *Valuation*. The extent to which a partner bears the economic risk of loss for a partnership liability as a result of a direct pledge described in paragraph (h)(1) of this section or an indirect pledge described in paragraph (h)(2) of this section is limited to the net fair market value of the property (pledged property) at the time of the pledge or contribution. If a partner provides additional pledged property, the addition is treated as a new pledge and the net fair market value of the pledged property (including but not limited to the additional property) must be determined at that time. For purposes of this paragraph (h), if pledged property is subject to one or more other obligations, those obligations must be taken into account in determining the net fair market value of pledged property at the time of the pledge or contribution.

(4) *Partner's promissory note*. For purposes of paragraph (h)(2) of this section, a promissory note of the partner or related person that is contributed to the partnership shall not be taken into account unless the note is readily tradeable on an established securities market.

(i) *Treatment of recourse liabilities in tiered partnerships*. If a partnership (the "upper-tier partnership") owns (directly or indirectly through one or more partnerships) an interest in another partnership (the "lower-tier partnership"), the liabilities of the lower-tier partnership are allocated to the upper-tier partnership in an amount equal to the sum of the following—

(1) The amount of the economic risk of loss that the upper-tier partnership bears with respect to the liabilities; and

(2) Any other amount of the liabilities with respect to which partners of the upper-tier partnership bear the economic risk of loss.

(j) *Anti-abuse rules*—(1) *In general*. An obligation of a partner or related person to make a payment may be disregarded or treated as an obligation of another person for purposes of this section if facts and circumstances indicate that a principal purpose of the arrangement between the parties is to eliminate the partner's economic risk of loss with respect to that obligation

or create the appearance of the partner or related person bearing the economic risk of loss when, in fact, the substance of the arrangement is otherwise. Circumstances with respect to which a payment obligation may be disregarded include, but are not limited to, the situations described in paragraphs (j)(2) and (j)(3) of this section.

(2) *Arrangements tantamount to a guarantee.* Irrespective of the form of a contractual obligation, a partner is considered to bear the economic risk of loss with respect to a partnership liability, or a portion thereof, to the extent that:

(i) The partner or related person undertakes one or more contractual obligations so that the partnership may obtain a loan;

(ii) The contractual obligations of the partner or related person eliminate substantially all the risk to the lender that the partnership will not satisfy its obligations under the loan; and

(iii) One of the principal purposes of using the contractual obligations is to attempt to permit partners (other than those who are directly or indirectly liable for the obligation) to include a portion of the loan in the basis of their partnership interests.

The partners are considered to bear the economic risk of loss for the liability in accordance with their relative economic burdens for the liability pursuant to the contractual obligations. For example, a lease between a partner and a partnership which is not on commercially reasonable terms may be tantamount to a guarantee by the partner of a partnership liability.

(3) *Plan to circumvent or avoid the obligation.* An obligation of a partner to make a payment is not recognized if the facts and circumstances evidence a plan to circumvent or avoid the obligation.

(4) *Example.* The following example illustrates the principle of paragraph (j)(3) of this section.

Example. Plan to circumvent or avoid obligation. A and B form a general partnership. A, a corporation, contributes \$20,000 and B contributes \$80,000 to the partnership. A is obligated to restore any deficit in its partnership capital account. The partnership agreement allocates losses 20% to A and 80% to B until B's capital account is reduced to zero, after which all losses are allocated to A. The partnership purchases depreciable

property for \$250,000 using its \$100,000 cash and a \$150,000 recourse loan from a bank. B guarantees payment of the \$150,000 loan to the extent the loan remains unpaid after the bank has exhausted its remedies against the partnership. A is a subsidiary, formed by a parent of a consolidated group, with capital limited to \$20,000 to allow the consolidated group to enjoy the tax losses generated by the property while at the same time limiting its monetary exposure for such losses. These facts, when considered together with B's guarantee, indicate a plan to circumvent or avoid A's obligation to contribute to the partnership. The rules of section 752 must be applied as if A's obligation to contribute did not exist. Accordingly, the \$150,000 liability is a recourse liability that is allocated entirely to B.

(k) *Effect of a disregarded entity—(1) In general.* In determining the extent to which a partner bears the economic risk of loss for a partnership liability, an obligation under paragraph (b)(1) of this section (§1.752-2(b)(1) payment obligation) of a business entity that is disregarded as an entity separate from its owner under sections 856(i) or 1361(b)(3) or §§301.7701-1 through 301.7701-3 of this chapter (disregarded entity) is taken into account only to the extent of the net value of the disregarded entity as of the allocation date (as defined in paragraph (k)(2)(iv) of this section) that is allocated to the partnership liability as determined under the rules of this paragraph (k). The rules of this paragraph (k) do not apply to a §1.752-2(b)(1) payment obligation of a disregarded entity to the extent that the owner of the disregarded entity is otherwise required to make a payment (that satisfies the requirements of paragraph (b)(1) of this section) with respect to the obligation of the disregarded entity.

(2) *Net value of a disregarded entity—(i) Definition.* For purposes of this paragraph (k), the net value of a disregarded entity equals the following—

(A) The fair market value of all assets owned by the disregarded entity that may be subject to creditors' claims under local law (including the disregarded entity's enforceable rights to contributions from its owner and the fair market value of an interest in

any partnership other than the partnership for which net value is being determined, but excluding the disregarded entity's interest in the partnership for which the net value is being determined and the net fair market value of property pledged to secure a liability of the partnership under paragraph (h)(1) of this section); less

(B) All obligations of the disregarded entity that do not constitute § 1.752-2(b)(1) payment obligations of the disregarded entity.

(ii) *Timing of the net value determination*—(A) *Initial determination*. If a partnership interest is held by a disregarded entity, and the partnership has or incurs a liability, all or a portion of which may be allocable to the owner of the disregarded entity under this paragraph (k), the disregarded entity's net value must be initially determined on the allocation date described in paragraph (k)(2)(iv) of this section.

(B) *Other events*. If a partnership interest is held by a disregarded entity, and the partnership has or incurs a liability, all or a portion of which may be allocable to the owner of the disregarded entity under this paragraph (k), then, if one or more valuation events (as defined in paragraph (k)(2)(iii) of this section) occur during the partnership taxable year, except as provided in paragraph (k)(2)(iii)(E) of this section, the net value of the disregarded entity is determined on the allocation date described in paragraph (k)(2)(iv) of this section.

(iii) *Valuation events*. The following are valuation events for purposes of this paragraph (k):

(A) A more than de minimis contribution to a disregarded entity of property other than property pledged to secure a partnership liability under paragraph (h)(1) of this section, unless the contribution is followed immediately by a contribution of equal net value by the disregarded entity to the partnership for which the net value of the disregarded entity otherwise would be determined, taking into account any obligations assumed or taken subject to in connection with such contributions.

(B) A more than de minimis distribution from a disregarded entity of property other than property pledged to se-

cure a partnership liability under paragraph (h)(1) of this section, unless the distribution immediately follows a distribution of equal net value to the disregarded entity by the partnership for which the net value of the disregarded entity otherwise would be determined, taking into account any obligations assumed or taken subject to in connection with such distributions.

(C) A change in the legally enforceable obligation of the owner of the disregarded entity to make contributions to the disregarded entity.

(D) The incurrence, refinancing, or assumption of an obligation of the disregarded entity that does not constitute a § 1.752-2(b)(1) payment obligation of the disregarded entity.

(E) The sale or exchange of a non-de minimis asset of the disregarded entity (in a transaction that is not in the ordinary course of business). In this case, the net value of the disregarded entity may be adjusted only to reflect the difference, if any, between the fair market value of the asset at the time of the sale or exchange and the fair market value of the asset when the net value of the disregarded entity was last determined. The adjusted net value is taken into account for purposes of § 1.752-2(k)(1) as of the allocation date.

(iv) *Allocation Date*. For purposes of this paragraph (k), the allocation date is the earlier of—

(A) The first date occurring on or after the date on which the requirement to determine the net value of a disregarded entity arises under paragraph (k)(2)(ii)(A) or (B) of this section on which the partnership otherwise determines a partner's share of partnership liabilities under §§ 1.705-1(a) and 1.752-4(d); or

(B) The end of the partnership's taxable year in which the requirement to determine the net value of a disregarded entity arises under paragraph (k)(2)(ii)(A) or (B) of this section.

(3) *Multiple liabilities*. If one or more disregarded entities have § 1.752-2(b)(1) payment obligations with respect to one or more liabilities of a partnership, the partnership must allocate the net value of each disregarded entity among partnership liabilities in a reasonable

and consistent manner, taking into account the relative priorities of those liabilities.

(4) *Reduction in net value of a disregarded entity.* For purposes of this paragraph (k), the net value of a disregarded entity is determined by taking into account a subsequent reduction in the net value of the disregarded entity if, at the time the net value of the disregarded entity is determined, it is anticipated that the net value of the disregarded entity will subsequently be reduced and the reduction is part of a plan that has as one of its principal purposes creating the appearance that a partner bears the economic risk of loss for a partnership liability.

(5) *Information to be provided by the owner of a disregarded entity.* A partner that may be treated as bearing the economic risk of loss for a partnership liability based upon a § 1.752-2(b)(1) payment obligation of a disregarded entity must provide information to the partnership as to the entity's tax classification and the net value of the disregarded entity that is appropriately allocable to the partnership's liabilities on a timely basis.

(6) *Examples.* The following examples illustrate the rules of this paragraph (k):

Example 1. Disregarded entity with net value of zero. (i) In 2007, A forms a wholly owned domestic limited liability company, LLC, with a contribution of \$100,000. A has no liability for LLC's debts, and LLC has no enforceable right to contribution from A. Under § 301.7701-3(b)(1)(ii) of this chapter, LLC is a disregarded entity. Also in 2007, LLC contributes \$100,000 to LP, a limited partnership with a calendar year taxable year, in exchange for a general partnership interest in LP, and B and C each contributes \$100,000 to LP in exchange for a limited partnership interest in LP. The partnership agreement provides that only LLC is required to make up any deficit in its capital account. On January 1, 2008, LP borrows \$300,000 from a bank and uses \$600,000 to purchase nondepreciable property. The \$300,000 debt is secured by the property and is also a general obligation of LP. LP makes payments of only interest on its \$300,000 debt during 2008. LP has a net taxable loss in 2008, and under §§ 1.705-1(a) and 1.752-4(d), LP determines its partners' shares of the \$300,000 debt at the end of its taxable year, December 31, 2008. As of that date, LLC holds no assets other than its interest in LP.

(ii) Because LLC is a disregarded entity, A is treated as the partner in LP for Federal tax purposes. Only LLC has an obligation to make a payment on account of the \$300,000 debt if LP were to constructively liquidate as described in paragraph (b)(1) of this section. Therefore, under this paragraph (k), A is treated as bearing the economic risk of loss for LP's \$300,000 debt only to the extent of LLC's net value. Because that net value is \$0 on December 31, 2008, when LP determines its partners' shares of its \$300,000 debt, A is not treated as bearing the economic risk of loss for any portion of LP's \$300,000 debt. As a result, LP's \$300,000 debt is characterized as nonrecourse under § 1.752-1(a) and is allocated as required by § 1.752-3.

Example 2. Disregarded entity with positive net value. (i) The facts are the same as in *Example 1* except that on January 1, 2009, A contributes \$250,000 to LLC. On January 5, 2009, LLC borrows \$100,000 and LLC shortly thereafter uses the \$350,000 to purchase unimproved land. LP makes payments of only interest on its \$300,000 debt during 2009. As of December 31, 2009, LLC holds its interest in LP and the land, the value of which has declined to \$275,000. LP has a net taxable loss in 2009, and under §§ 1.705-1(a) and 1.752-4(d), LP determines its partners' shares of the \$300,000 debt at the end of its taxable year, December 31, 2009.

(ii) A's contribution of \$250,000 to LLC on January 1, 2009, constitutes a more than de minimis contribution of property to LLC under paragraph (k)(2)(iii)(A) of this section and the debt incurred by LLC on January 5, 2009, is a valuation event under paragraph (k)(2)(iii)(D) of this section. Accordingly, under paragraph (k)(2)(ii) of this section, LLC's value must be redetermined as of the end of the partnership's taxable year. At that time LLC's net value is \$175,000 (\$275,000 land—\$100,000 debt). Accordingly, \$175,000 of LP's \$300,000 debt will be recharacterized as recourse under § 1.752-1(a) and allocated to A under this section, and the remaining \$125,000 of LP's \$300,000 debt will remain characterized as nonrecourse under § 1.752-1(a) and is allocated as required by § 1.752-3.

Example 3. Multiple partnership liabilities. (i) The facts are the same as in *Example 2* except that on January 1, 2010, A forms another wholly owned domestic limited liability company, LLC2, with a contribution of \$120,000. Shortly thereafter, LLC2 uses the \$120,000 to purchase stock in X corporation. A has no liability for LLC2's debts, and LLC2 has no enforceable right to contribution from A. Under § 301.7701-3(b)(1)(ii) of this chapter, LLC2 is a disregarded entity. On July 1, 2010, LP borrows \$100,000 from a bank and uses the \$100,000 to purchase nondepreciable property. The \$100,000 debt is secured by the property and is also a general obligation of LP. The \$100,000 debt is senior in priority to LP's existing \$300,000 debt. Also, on

July 1, 2010, LLC2 agrees to guarantee both LP's \$100,000 and \$300,000 debts. LP makes payments of only interest on both its \$100,000 and \$300,000 debts during 2010. LP has a net taxable loss in 2010 and, under §§1.705-1(a) and 1.752-4(d), must determine its partners' shares of its \$100,000 and \$300,000 debts at the end of its taxable year, December 31, 2010. As of that date, LLC holds its interest in LP and the land, and LLC2 holds the X corporation stock which has appreciated in value to \$140,000.

(ii) Both LLC and LLC2 have obligations to make a payment on account of LP's debts if LP were to constructively liquidate as described in paragraph (b)(1) of this section. Therefore, under paragraph (k)(1) of this section, A is treated as bearing the economic risk of loss for LP's \$100,000 and \$300,000 debts only to the extent of the net values of LLC and LLC2, as allocated among those debts in a reasonable and consistent manner pursuant to paragraph (k)(3) of this section.

(iii) No events have occurred that would allow a valuation of LLC under paragraph (k)(2)(iii) of this section. Therefore, LLC's net value remains \$175,000. LLC2's net value as of December 31, 2010, when LP determines its partners' shares of its liabilities, is \$140,000. Under paragraph (k)(3) of this section, LP must allocate the net values of LLC and LLC2 between its \$100,000 and \$300,000 debts in a reasonable and consistent manner. Because the \$100,000 debt is senior in priority to the \$300,000 debt, LP first allocates the net values of LLC and LLC2, pro rata, to its \$100,000 debt. Thus, LP allocates \$56,000 of LLC's net value and \$44,000 of LLC2's net value to its \$100,000 debt, and A is treated as bearing the economic risk of loss for all of LP's \$100,000 debt. As a result, all of LP's \$100,000 debt is characterized as recourse under §1.752-1(a) and is allocated to A under this section. LP then allocates the remaining \$119,000 of LLC's net value and LLC2's \$96,000 net value to its \$300,000 debt, and A is treated as bearing the economic risk of loss for a total of \$215,000 of the \$300,000 debt. As a result, \$215,000 of LP's \$300,000 debt is characterized as recourse under §1.752-1(a) and is allocated to A under this section, and the remaining \$85,000 of LP's \$300,000 debt is characterized as nonrecourse under §1.752-1(a) and is allocated as required by §1.752-3. This example illustrates one reasonable method of allocating net values of disregarded entities among multiple partnership liabilities.

Example 4. Disregarded entity with interests in two partnerships. (i) In 2007, B forms a wholly owned domestic limited liability company, LLC, with a contribution of \$175,000. B has no liability for LLC's debts and LLC has no enforceable right to contribution from B. Under §301.7701-3(b)(1)(ii) of this chapter, LLC is a disregarded entity. LLC contributes \$50,000 to LP1 in exchange for a general partnership interest in LP1,

and \$25,000 to LP2 in exchange for a general partnership interest in LP2. LLC retains the \$100,000 in cash. Both LP1 and LP2 have taxable years than end on December 31 and, under both LP1's and LP2's partnership agreements, only LLC is required to make up any deficit in its capital account. During 2007, LP1 and LP2 incur partnership liabilities that are general obligations of the partnership. LP1 borrows \$300,000 (Debt 1), and LP2 borrows \$60,000 (Debt 2) and \$40,000 (Debt 3). Debt 2 is senior in priority to Debt 3. LP1 and LP2 make payments of only interest on Debts 1, 2, and 3 during 2007. As of the end of taxable year 2007, LP1 and LP2 each have a net taxable loss and must determine its partners' shares of partnership liabilities under §§1.705-1(a) and 1.752-4(d) as of December 31, 2007. As of that date, LLC's interest in LP1 has a fair market value of \$45,000, and LLC's interest in LP2 has a fair market value of \$15,000.

(ii) Because LLC is a disregarded entity, B is treated as the partner in LP1 and LP2 for federal tax purposes. Only LLC has an obligation to make a payment on account of Debts 1, 2, and 3 if LP1 and LP2 were to constructively liquidate as described in paragraph (b)(1) of this section. Therefore, under this paragraph (k), B is treated as bearing the economic risk of loss for LP1's and LP2's liabilities only to the extent of LLC's net value as of the allocation date, December 31, 2007.

(iii) LLC's net value with respect to LP1 is \$115,000 (\$100,000 cash + \$15,000 interest in LP2). Therefore, under paragraph (k)(1) of this section, B is treated as bearing the economic risk of loss for \$115,000 of Debt 1. Accordingly, \$115,000 of LP1's \$300,000 debt is characterized as recourse under §1.752-1(a) and is allocated to B under this section. The balance of Debt 1 (\$185,000) is characterized as nonrecourse under §1.752-1(a) and is allocated as required by §1.752-3.

(iv) LLC's net value with respect to LP2 is \$145,000 (\$100,000 cash + \$45,000 interest in LP1). Therefore, under paragraph (k)(1) of this section, B is treated as bearing the economic risk of loss with respect to Debts 2 and 3 only to the extent of \$145,000. Because Debt 2 is senior in priority to Debt 3, LP2 first allocates \$60,000 of LLC's net value to Debt 2. LP2 then allocates \$40,000 of LLC's net value to Debt 3. As a result, both Debts 2 and 3 are characterized as recourse under §1.752-1(a) and allocated to B. This example illustrates one reasonable method of allocating the net value of a disregarded entity among multiple partnership liabilities.

(l) *Effective dates.* Paragraph (a), the last sentence of paragraph (b)(6), and paragraphs (h)(3) and (k) of this section apply to liabilities incurred or assumed by a partnership on or after October 11, 2006, other than liabilities incurred or

assumed by a partnership pursuant to a written binding contract in effect prior to that date. The rules applicable to liabilities incurred or assumed (or subject to a binding contract in effect) prior to October 11, 2006 are contained in § 1.752-2 in effect prior to October 11, 2006, (see 26 CFR part 1 revised as of April 1, 2006).

[T.D. 8380, 56 FR 66351, Dec. 23, 1991; 57 FR 4913, Feb. 10, 1992; 57 FR 5054, Feb. 12, 1992; 57 FR 5511, Feb. 14, 1992; T.D. 9289, 71 FR 59672, Oct. 11, 2006]

§ 1.752-3 Partner's share of nonrecourse liabilities.

(a) *In general.* A partner's share of the nonrecourse liabilities of a partnership equals the sum of paragraphs (a)(1) through (a)(3) of this section as follows—

(1) The partner's share of partnership minimum gain determined in accordance with the rules of section 704(b) and the regulations thereunder;

(2) The amount of any taxable gain that would be allocated to the partner under section 704(c) (or in the same manner as section 704(c) in connection with a revaluation of partnership property) if the partnership disposed of (in a taxable transaction) all partnership property subject to one or more nonrecourse liabilities of the partnership in full satisfaction of the liabilities and for no other consideration; and

(3) The partner's share of the excess nonrecourse liabilities (those not allocated under paragraphs (a)(1) and (a)(2) of this section) of the partnership as determined in accordance with the partner's share of partnership profits. The partner's interest in partnership profits is determined by taking into account all facts and circumstances relating to the economic arrangement of the partners. The partnership agreement may specify the partners' interests in partnership profits for purposes of allocating excess nonrecourse liabilities provided the interests so specified are reasonably consistent with allocations (that have substantial economic effect under the section 704(b) regulations) of some other significant item of partnership income or gain. Alternatively, excess nonrecourse liabilities may be allocated among the partners in accordance with the manner in

which it is reasonably expected that the deductions attributable to those nonrecourse liabilities will be allocated. Additionally, the partnership may first allocate an excess nonrecourse liability to a partner up to the amount of built-in gain that is allocable to the partner on section 704(c) property (as defined under § 1.704-3(a)(3)(ii)) or property for which reverse section 704(c) allocations are applicable (as described in § 1.704-3(a)(6)(i)) where such property is subject to the nonrecourse liability to the extent that such built-in gain exceeds the gain described in paragraph (a)(2) of this section with respect to such property. This additional method does not apply for purposes of § 1.707-5(a)(2)(ii). To the extent that a partnership uses this additional method and the entire amount of the excess nonrecourse liability is not allocated to the contributing partner, the partnership must allocate the remaining amount of the excess nonrecourse liability under one of the other methods in this paragraph (a)(3). Excess nonrecourse liabilities are not required to be allocated under the same method each year.

(b) *Allocation of a single nonrecourse liability among multiple properties—*(1) *In general.* For purposes of determining the amount of taxable gain under paragraph (a)(2) of this section, if a partnership holds multiple properties subject to a single nonrecourse liability, the partnership may allocate the liability among the multiple properties under any reasonable method. A method is not reasonable if it allocates to any item of property an amount of the liability that, when combined with any other liabilities allocated to the property, is in excess of the fair market value of the property at the time the liability is incurred. The portion of the nonrecourse liability allocated to each item of partnership property is then treated as a separate loan under paragraph (a)(2) of this section. In general, a partnership may not change the method of allocating a single nonrecourse liability under this paragraph (b) while any portion of the liability is outstanding. However, if one or more of the multiple properties subject to the